

**Joint Evaluation of the Federal Financial  
Institutions Examination Council**

OIG-02-099

June 21, 2002



**Office of Inspector General**

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**The Department of the Treasury**



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

OFFICE OF  
INSPECTOR GENERAL

June 21, 2002

MEMORANDUM FOR JAMES E. GILLERAN, DIRECTOR  
OFFICE OF THRIFT SUPERVISION

FROM: Donald R. Kassel *Donald R. Kassel*  
National Director, Banking and Fiscal Service

SUBJECT: Final Report - Joint Evaluation of the  
Federal Financial Institutions Examination  
Council (OIG-02-099)

Attached is the subject final report. We performed this evaluation jointly with the Offices of Inspector General for the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System. The results and conclusions drawn from this review showed that the Council is accomplishing its legislative mission of prescribing uniform principles and standards for the examination of financial institutions and its role is appropriate going forward.

The comments you provided are incorporated, in part, in the report and included in their entirety as an appendix. We appreciate the cooperation and courtesies you and your staff extended to us during this review.

If you have any questions concerning this report, you may contact me at (202) 927-6512, or a member of your staff may contact Michael Sinko, Audit Manager at (202) 927-5775.

cc: Randy Thomas  
Director of Internal Review

Attachment



OFFICE OF  
INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

June 21, 2002

MEMORANDUM FOR JOHN D. HAWKE, JR., COMPTROLLER  
OFFICE OF THE COMPTROLLER OF THE CURRENCY

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National Director, Banking and Fiscal Service

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cc: Laura L. McAuliffe  
Senior Advisor OIG/GAO Liaison

Attachment

# **BANKING AGENCY OFFICES OF INSPECTOR GENERAL**



## **Joint Evaluation of the Federal Financial Institutions Examination Council**

**June 21, 2002**

**Conducted by  
Offices of Inspector General at the:**

- ❖ **Department of the Treasury**
- ❖ **Federal Deposit Insurance Corporation**
- ❖ **Board of Governors of the Federal Reserve System**

# Offices of Inspector General



Department of the  
Treasury



Federal Deposit Insurance  
Corporation



Board of Governors of the  
Federal Reserve System

June 21, 2002

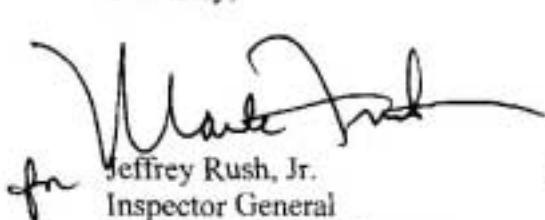
The Honorable Donald E. Powell, Chairman  
Federal Financial Institutions Examination Council  
2000 K. St. NW, Suite 310  
Washington, D.C. 20006

Dear Mr. Powell:

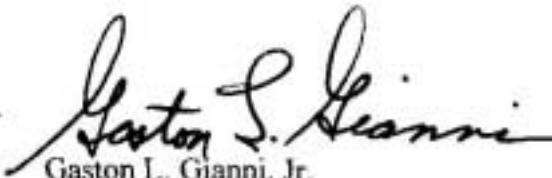
The Inspectors General of the Department of the Treasury, Federal Deposit Insurance Corporation, and the Board of Governors of the Federal Reserve System have completed a joint evaluation of the Federal Financial Institutions Examination Council. The objectives of our review were to evaluate whether the FFIEC: (1) is meeting its mission of prescribing uniform principles and standards for the examination of financial institutions and (2) should have an increased coordinating role as a result of the Gramm-Leach-Bliley Act. A copy of our report is attached.

Should you have any questions or need additional information, please contact any one of us.

Sincerely,

  
for Jeffrey Rush, Jr.  
Inspector General

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## INTRODUCTION

The Inspectors General of the Department of the Treasury (Treasury), the Federal Deposit Insurance Corporation (FDIC), and the Board of Governors of the Federal Reserve System (FRB) have completed a joint evaluation of the Federal Financial Institutions Examination Council (FFIEC). We initiated this review as a result of an audit survey of the FFIEC that the banking agency Inspector General (IG) offices conducted during early 1998.<sup>1</sup> The 1998 survey recommended additional audit work in several areas including reviewing the Council's effectiveness in coordinating regulatory issues and fostering its legislative mandates and goals.

As we initiated our review objectives, we met with staff representatives from the Subcommittee on Oversight and Investigations (Subcommittee), Committee on Financial Services, U.S. House of Representatives. The Subcommittee staff asked us about the Council's efforts to accomplish its mission and whether the FFIEC should have a broadened role in coordinating banking, insurance, and securities regulators, or whether a separate group should be developed and modeled after the FFIEC for coordinating interagency supervision efforts under the Gramm-Leach-Bliley Act (GLBA). Accordingly, the objectives of our review were to evaluate whether the FFIEC:

- is meeting its mission of prescribing uniform principles and standards for the examination of financial institutions and
- should have an increased coordinating role as a result of the GLBA.

The Subcommittee staff also asked us to (1) obtain the views of banking industry associations regarding FFIEC effectiveness and communication efforts and (2) determine whether the FFIEC had issued a uniform examination report form and whether such a form would prevent banks from "shopping around" to find a banking regulator with lax examination standards, known as regulator shopping. This report addresses those two issues as part of our first objective. To accomplish our evaluation, we interviewed Council principals, banking agency supervision officials, and representatives from banking trade associations. We also reviewed documentation from the FFIEC and the federal banking agencies. Details of our methodology are included as Appendix I of this report. Appendix III contains a list of acronyms used in our report. We conducted our evaluation between October 2001 and March 2002, in accordance with the President's Council on Integrity and Efficiency's *Quality Standards for Inspections*.

## BACKGROUND

The FFIEC was established on March 10, 1979, pursuant to Title X of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (Public Law 95-630, The FFIEC Act). The FFIEC is a formal interagency body consisting of five financial regulatory agencies empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by its member agencies. The member agencies consist of the FRB, the FDIC, the

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<sup>1</sup> The banking agency IGs include the Treasury IG, which oversees the Office of the Comptroller of the Currency and the Office of Thrift Supervision; the FDIC IG, the FRB IG, and the National Credit Union Administration IG.

National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).<sup>2</sup> Table 1 presents banking regulators and the types of institutions that they supervise.

**Table 1: Banking Regulators and Types of Institutions Supervised**

<b>Regulator</b>	<b>Regulatory Responsibilities</b>
<b>OCC</b>	Charters, regulates, and supervises all national banks. Also supervises the federal branches and agencies of foreign banks.
<b>OTS</b>	Primary regulator of all federal and many state-chartered thrift institutions, which include savings banks and savings and loan associations.
<b>FDIC</b>	Primary federal regulator of state-chartered "nonmember" banks--commercial and savings banks that are not members of the Federal Reserve System.
<b>FRB</b>	Primary federal regulator for state-chartered banks that are members of the Federal Reserve System, as well as for all bank and financial holding companies and certain operations of foreign banking organizations.
<b>NCUA</b>	Charters and supervises federal credit unions and insures the deposits in all federal and many state-chartered credit unions.
<b>State Banking Agencies</b>	Supervise state-chartered banks, savings institutions, and credit unions.

Source: Regulator Web sites.

The overall intent of the legislation was to promote consistency in federal examinations and progressive and vigilant supervision of banks. Additional responsibilities based on subsequent legislation included providing public access to Home Mortgage Disclosure Act (HMDA)<sup>3</sup> data and monitoring state government certification and licensing requirements for real estate appraisers through a separate Appraisal Subcommittee. The FFIEC is required to prepare an annual report to Congress covering its activities during the preceding year. Appendix IV contains excerpts from the enacting legislation.

### **FFIEC Operations, Staffing, and Funding**

The FFIEC is comprised of the Comptroller of the Currency, the Chairman of the FDIC, a Governor from the FRB, the Director of the OTS, and the Chairman of the NCUA (the principals). The FFIEC Act established a chairmanship with a 2-year term, which rotates among the Council principals. The FDIC Chairman assumed the FFIEC Chairmanship in April 2001. The OTS Director will be the next FFIEC Chairman.

Six interagency task forces consisting of representatives from each member agency perform the primary work of the Council. The task forces are functionally aligned along the following areas—supervision, consumer compliance, examiner training, information sharing, reports, and surveillance systems. In addition, the Council established a Legal Advisory Group to provide legal support and a State Liaison Committee (SLC), comprised of five state banking

<sup>2</sup> FFIEC membership was established by statute. The OTS replaced the Federal Home Loan Bank Board on the FFIEC in 1989.

<sup>3</sup> The HMDA, enacted in 1975, requires certain financial institutions to report data about home purchase and home improvement loans to their supervisory agencies and requires the FFIEC to produce annual tables for each metropolitan statistical area in the United States showing the geographic distribution of housing-related lending.



commissioners, to encourage the application of uniform examination principles and standards by the state and federal supervisory agencies.

The FFIEC has four staff who support Council operations, two staff who coordinate the Uniform Bank Performance Report (UBPR), and nine staff dedicated to the examiner training function. FFIEC Council operations staff also share a receptionist with FFIEC's Appraisal Subcommittee.

The task forces research interagency projects and prepare policy statements and recommendations for the Council's consideration. The task forces may approve policy statements under delegated authority if there is unanimous agreement by the task force members. The task forces also assign agency staff to subcommittees and working groups to research specific interagency projects. Most of the task forces meet monthly to discuss on-going projects. About one-half of interagency projects are originated by the Council and one-half are originated by the task forces.

The FFIEC is funded through assessments of its five member agencies for operating expenses and tuition costs. During 2001, the FFIEC incurred expenses of about \$6.2 million, most of which was for salaries and benefits (24 percent of total expenses) and data processing costs (54 percent of total expenses).

## **RESULTS IN BRIEF**

The FFIEC is accomplishing its legislative mission of prescribing uniform principles, standards, and report forms and is achieving coordination between the banking agencies. Further, most officials stated the FFIEC's role and mission were appropriate going forward. Notwithstanding, some officials indicated the FFIEC could accomplish its mission more effectively and noted the FFIEC could be bureaucratic and take too long to complete interagency projects. The Council has recently discussed a number of measures to improve FFIEC effectiveness, including having the principals more actively involved in FFIEC matters and developing annual goals, objectives, and work priorities for the task forces. We are suggesting the Council memorialize these ideas in a more permanent document, such as the FFIEC's *Rules of Operations*, to better ensure that future Council members continue to practice those measures.

Banking industry and professional associations indicated that the FFIEC could be more proactive in communicating with the industry. One representative noted there is currently no formal mechanism for communicating with the FFIEC. Several representatives indicated it would be helpful if the FFIEC published an annual agenda, task force points of contact, and status information about ongoing or planned projects on the FFIEC Web site. We encourage the FFIEC to look for opportunities to improve communication with the trade associations where appropriate.

We asked agency officials to identify major risks and emerging issues facing the banking industry and to describe FFIEC and banking agency guidance issued in response. We concluded that the FFIEC and the banking agencies had issued guidance responsive to those major risks and emerging issues. Further, most officials indicated that the FFIEC and the banking agencies had

achieved uniformity in critical areas. Several such examples are the Uniform Financial Institutions Rating System (UFIRS), a common examination rating system, and standard quarterly financial reports submitted by commercial banks and savings banks to the FDIC. Several officials stated that such achievements mitigated the need for a uniform report of examination. Further, none of the officials we spoke with indicated that banks made charter changes based on differences in supervision between the banking agencies.

With respect to the FFIEC's role under the GLBA, most officials indicated that GLBA had not significantly impacted the FFIEC and were not in favor of broadening the FFIEC to include regulatory representatives from the insurance and securities industries. Further, most officials did not see a need for a separate coordinating entity under GLBA modeled after the FFIEC. The officials indicated that coordination under GLBA was occurring as needed on an ad hoc basis and through periodic cross-sector meetings hosted by the FRB. However, while the individual banking agencies had signed bilateral information sharing agreements with a number of state insurance commissioners, some officials indicated the relationship between the banking agencies and the SEC needed to be improved through better dialogue. The banking agencies and SEC are working on national memoranda of understanding (MOU) covering the sharing of information about broker-dealers in financial holding companies and have arrangements to ensure that critical information is shared on a case-by-case basis.

## **FFIEC IS ACHIEVING ITS LEGISLATIVE MISSION**

The FFIEC is accomplishing its legislative mission of prescribing uniform principles, standards, and report forms, and the FFIEC's legislative mission remains valid and appropriate. However, the FFIEC could accomplish its mission more effectively. Most officials we interviewed indicated that the FFIEC was a useful forum for achieving coordination among the banking agencies and was achieving its legislative mandate. One of the principals noted that as long as the banking industry has multiple regulators, the FFIEC was vital to achieving coordination. Another principal stated that the FFIEC was an effective vehicle to discuss inconsistencies between agencies, particularly where the banking agencies have to implement a common statute. However, one principal characterized the FFIEC as being extraordinarily unwieldy, in part, due to the formality of Council meetings and because of the number of agencies represented by the Council. For those reasons, the principal stated that the FFIEC was not meeting its legislative mission of achieving coordination.

Virtually all of the officials we interviewed acknowledged that the FFIEC could improve its operations and become more effective and efficient. That being said, none of the officials were in favor of additional legislation to improve the FFIEC. One principal indicated there was a danger of building in too much bureaucracy at the FFIEC and expressed concern that additional legislation giving the FFIEC more authority could make the Council more cumbersome.

Instead, most officials were in favor of the Council taking measures to improve FFIEC operations within the existing legislative framework. The Council Chairman took steps in that direction by issuing a memorandum entitled, *FFIEC Effectiveness in 2002* to the other principals in December 2001. We have included a copy of that memorandum as Appendix V. The

memorandum outlined the Chairman's ideas for how to make the FFIEC more effective, such as having annual goals and objectives and priority lists and time frames for project completion; the principals more actively involved in Council activities and in monitoring completion of projects; and improved communication between the principals and agency staff. The FFIEC discussed these items during the February 2002 Council meeting.

We asked the other principals for their views on the Chairman's memorandum. Most were supportive of the memorandum and expressed the following views:

- One principal indicated that it was important to obtain the principals' interest early enough in the process of deliberating on projects to fully understand the issues. Several principals also agreed that more frequent meetings were needed between them. However, they noted the informal meetings, such as the "Regulator Breakfasts" were the most important and provided opportunities for the principals to discuss on-going projects.
- With respect to establishing goals, objectives, and priority lists, two of the principals noted that it might be difficult for the Council to establish and implement goals and objectives because the industry changes quickly and the FFIEC must be ready when new issues surface. Supervision officials from one agency noted that Council projects are high-priority by virtue of being raised at the Council level and that the individual agencies have different priorities based on their respective agency missions.
- Further, one principal stated that it was a good idea for the new Chairman to assert his leadership; however, the principal indicated that the Council was already doing most of the things that the Chairman suggested. Two agency supervision directors also stated that the FFIEC was already addressing most of the issues that the Chairman had suggested but agreed the memorandum addressed important factors for the FFIEC's continued success.

A number of the officials noted that the Council's success depended in large part on the individual principal's interaction and level of commitment to the FFIEC. One senior agency official indicated that while the FFIEC exists in law, in practice the FFIEC exists at the consent of the Council and task force members. One principal stated that personal relationships are important at all levels of the FFIEC and that without good relationships there is no basis for completing interagency projects. The principal concluded that the existing group of principals had worked well together.

We support the Chairman's ideas for making the FFIEC more effective. However, because the FFIEC chairmanship is only for a 2-year term, we suggest that the FFIEC memorialize those ideas related to setting goals and objectives, dispute resolution, and prioritization of work in a more permanent document, such as the FFIEC's *Rules of Operation*. By doing so, the FFIEC could better ensure that future Council members continue to implement those measures.

## **Banking and Professional Association Views**

Generally, representatives from banking associations<sup>4</sup> indicated that the banking industry benefited from having the FFIEC and concluded that a coordinated approach among the banking agencies likely yields the best product. Notwithstanding, the representatives noted that the interagency deliberation process was bureaucratic and slow. Representatives from one group indicated that the FFIEC Chairman's memorandum to improve FFIEC effectiveness was appropriate.

With respect to communications, officials told us they usually communicate directly with the individual banking agencies in lieu of the FFIEC. One representative noted there is no formal mechanism for communicating with the FFIEC and that the FFIEC has made no efforts to outreach or communicate with industry trade groups. Several associations indicated they would like the FFIEC to publish an annual agenda on the FFIEC Web site listing the major projects that the task forces plan to address so that the industry associations could comment on the issues. For example, two representatives noted that the FFIEC's Task Force on Consumer Compliance had invited the industry associations to a discussion on the Community Reinvestment Act (CRA).<sup>5</sup> The representatives indicated that the forum was very informative and the participants had a good exchange of ideas. They welcomed additional opportunities to participate in the discussion of interagency projects.

One banking association representative noted that the FFIEC had greatly improved its Web site by including links to HMDA and CRA reporting databases and UBPR information. However, the representative stated that the FFIEC could improve its Web site further by including more information about the various task forces, contact information for the task forces, and project listings. The representative also indicated that it would be beneficial if the FFIEC would periodically solicit ideas or suggestions from the banking industry.

The FFIEC Chairman has indicated an interest to improve communications with the industry. Moreover, earlier communications with the trade associations would likely surface disagreements sooner and result in fewer comments during Federal Register comment periods. As such, we encourage the FFIEC to look for ways to improve communication with the trade associations where appropriate.

## **State Regulator Representation on the Council**

One principal and several banking industry representatives indicated that the FFIEC could be improved by allowing the state regulators to have voting status in deliberating Council matters. As discussed earlier, the FFIEC currently has the SLC, which is comprised of five

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<sup>4</sup> Groups such as the American Bankers Association and America's Community Bankers are industry trade associations, while a group such as the Conference of State Bank Supervisors is a professional organization representing the interests of the state banking commissioners.

<sup>5</sup> 12 U.S.C. 2901, the Community Reinvestment Act, enacted in 1977, requires that each insured depository institution's record in helping meet the credit needs of its entire community be evaluated periodically. CRA examinations are conducted by the federal agencies responsible for supervising depository institutions.

representatives from state agencies that supervise financial institutions. The SLC attends Council meetings, and representatives from the SLC participate in Supervision Task Force and Information System Subcommittee meetings; however, the SLC does not have voting rights with respect to task force or Council matters.

One principal noted that the FFIEC has enormous potential to be effective, but that the Council is underutilized in part because the state regulators do not have voting rights. An association representative suggested that the FFIEC needs to have more dialogue and better coordination with state banking agencies and stated the Council could be improved if it had a state presence with the authority to vote on interagency projects. Moreover, a representative from the Conference of State Bank Supervisors (CSBS) noted that CSBS had requested voting status on behalf of state bank regulators during discussions of H.R. 1408, the Financial Services Antifraud Network Act of 2001 (Antifraud Bill).<sup>6</sup> The Antifraud Bill passed the House of Representatives and was received in the Senate in November 2001.

It appears that Congress considered the state regulators' role when it created the FFIEC. As discussed earlier, the purpose of the FFIEC Act was to establish an interagency council to "...prescribe uniform principles and standards for the Federal examination of financial institutions..." Further, the Act established the SLC to "...encourage the application of uniform examination principles and standards by State and Federal supervisory agencies..." An FFIEC Special Historical Study *Origin and Development of the Examination Council*, dated February 1992 (FFIEC Historical Study), noted that the initial House and Senate Bills to establish an Examination Council called for a sixth Council member who would be the head of a state supervisory agency. However, that provision was not included in the final legislation.

### **Understanding the FFIEC's Mission and Staffing Limitations**

By statute, the FFIEC is a coordinating and policy-making entity. The Council has no operational or implementing authority to make rules or to monitor whether member agencies implement FFIEC guidance. Further, with the exception of a few administrative staff, representatives from the five member agencies conduct the FFIEC's task force work.

Interagency guidance may be issued under the auspices of the FFIEC or by one or more of the banking agencies as non-FFIEC joint agency guidance (joint guidance). Because the FFIEC does not have rulemaking authority, any projects resulting in rulemaking must be issued as joint guidance by the banking agencies. Several officials noted that projects are often researched as FFIEC projects and then issued as joint guidance either because they result in rulemaking or because they do not involve all of the FFIEC member agencies. Most officials did not equate a decision to issue joint guidance as reflecting negatively on the FFIEC. One supervision official characterized the decision to issue guidance under the auspices of the FFIEC as simply a difference in the letterhead appearing on the final policy statement.

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<sup>6</sup> Among other things, the Antifraud Bill requires financial regulators to develop networking procedures for the sharing of antifraud information and coordinate to further improve upon antifraud efforts. According to CSBS, the Bill originally included language that designated the FFIEC as the coordinator of an information sharing system that would specifically allow supervisory information to be shared among banking, securities, and insurance regulators.

We also asked the Principals if they would favor having Congress consider using the FFIEC for implementing cross-cutting initiatives such as the anti-money laundering responsibilities envisioned under the USA PATRIOT Act.<sup>7</sup> Most of the Principals we interviewed were not in favor of Congress assigning such responsibilities to the FFIEC, primarily due to the staffing limitations discussed above. One principal told us that Congress had contemplated assigning responsibility to the FFIEC for implementing the Antifraud Bill; however, the Council was able to persuade Congress not to do so. The principal indicated that it was important to remember that the FFIEC has no professional staff to perform analytical work and has no authority to write or issue regulations. The principal indicated that assigning additional responsibilities to the FFIEC would require a fundamental change to the mission and staffing of the FFIEC.

### **FFIEC Accomplishments, Challenges, and Responsiveness to Banking Industry Risks**

The FFIEC has experienced success when dealing with well-defined issues that are common to the banking agencies. However, the FFIEC has also been challenged in completing other critical projects timely. A few officials noted that not all projects are suited for review by the FFIEC. For example, if a project needs to be addressed immediately or does not concern all members, the FFIEC may not be the best forum for reviewing the project. Supervision officials of one agency suggested that projects suitable for the FFIEC usually involve issues that are of common concern to the member agencies, high-priority in nature, achievable with a firm deadline, and important to each of the principals.

We reviewed FFIEC Annual Reports from 1997 through 2001 to gauge FFIEC accomplishments and to understand the nature of FFIEC guidance and reporting forms. Table 2 presents an overview of the Council's accomplishments during our period of review. Further, a brief discussion of recent FFIEC accomplishments in selected categories is presented in the following table.

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<sup>7</sup> Public Law Number 107-56, Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001. The Act includes provisions to: enhance domestic security against terrorism, enhance surveillance procedures, develop international counter money laundering and related measures, amend the Bank Secrecy Act and make related improvements, establish or increase penalties related to currency crimes, increase appropriations for protecting the U.S. Northern Border, and enhance immigration provisions.

**Table 2: FFIEC Published Guidance Issued From 1997 Through 2001**

Category	Council	Task Forces				Total
		Supervision	Consumer Compliance	Reports	Surveillance Systems	
<b>Guidance</b>						
• Y2K	1	17			1	19
• Credit	2	11	2			15
• Capital	1	7				8
• CRA	2		7			9
• Information Technology	2	6				8
• Miscellaneous	3	8	6	2		19
<b>Reporting</b>						
• Call Report	4		1	3		8
• UBPR	2				2	4
• Other Reporting			1			1
<b>Total</b>	17	49	17	5	3	91

Source: OIG Analysis of FFIEC Annual Reports to Congress and the Council's Web site.

Year 2000: A number of officials we interviewed cited the FFIEC's involvement in coordinating guidance for the Y2K issue as a major success for the Council. One supervision official noted that the FFIEC and the banking regulators raised the Y2K issue before other industries. Another supervision official called the FFIEC's Y2K efforts a "huge success" and noted the banking agencies worked together very well in addressing Y2K. One principal suggested the Y2K efforts were successful because there was a known deadline, a small group of people involved, and a common perspective among the agencies. The FFIEC issued a number of Y2K-related publications including:

- Y2K safety and soundness guidelines;
- Interagency guidance regarding Y2K readiness and potential impact on customers;
- Guidance to financial institutions for testing for Y2K readiness;
- Y2K guidance on customer awareness programs and a customer brochure;
- Guidelines to financial institutions related to Y2K fraud prevention;
- Questions and answers concerning Y2K business contingency planning; and
- A Y2K lessons learned document.

Credit Risk: One supervision official we interviewed indicated the three major issues facing the banking industry continue to be "credit risk, credit risk, and credit risk." The official noted that a number of issues, such as subprime lending, are merely subsets of credit risk. For example:

- Allowance for Loan and Lease Losses (ALLL): Federally insured depository institutions are required to maintain adequate loan loss reserves to absorb estimated credit losses associated with their loan and lease portfolios. In July 2001, the FFIEC agencies, in consultation with the SEC, issued a policy statement on ALLL methodologies and documentation standards for financial institutions. The policy statement reflected the agencies' research on ALLL best practices and included examples to assist institutions in determining and documenting loan

loss allowances.

- **Subprime Lending:** Subprime lending involves the extension of credit to borrowers with poor or minimal credit histories. Such loans usually have relatively high rates of interest or fees, require intensive levels of servicing and collection efforts, and carry an increased probability that borrowers will not make good on their obligation. In 2001, the banking agencies issued expanded joint guidance intended to strengthen the examination and supervision of institutions with significant subprime lending programs. Major issues addressed in this guidance included the adequacy of ALLL and capital to support subprime lending programs, as well as guidance for loan review and classification. The FFIEC also began revising its subprime lending training materials for examiners in late 2001.

**Community Reinvestment Act:** CRA encourages depository institutions to help meet the needs of communities in which they operate, including low- and moderate-income neighborhoods. During 2001, the Task Force on Consumer Compliance published a revised interagency questions and answers document for CRA. The FFIEC also published *A Guide to CRA Data Collection and Reporting* on the Council's Web site for use by financial institutions required to report CRA data. With respect to examination guidance, the task force released joint examination procedures for evaluating institutions' compliance with the CRA Sunshine provisions of GLBA. Finally, the task force completed the transition to paperless reporting of HMDA data from financial institutions.

**Call Report:** Consistent with its legislative mandate to prescribe uniform reporting systems, the FFIEC also contributed to improvements in regulatory reporting. The FFIEC requires every national bank, state member bank, and insured non-member bank to file a Call Report as of the last day of each calendar quarter. Call Report data are used extensively by the bank regulatory agencies for offsite bank monitoring activities and are the primary source of data for the FFIEC's UBPR, an analytical tool used for bank supervisory, examination, and bank management purposes. During 2001, the banking agencies implemented substantial FFIEC revisions to the Call Report to make the report's content more relevant to the agencies' overall mission of maintaining a safe and sound banking system and to complement the agencies' emphasis on risk-focused supervision. These revisions eliminated some information while enhancing information on areas of growing risk, such as asset securitization activities.

Finally, several officials indicated that the FFIEC's benefits are not always that easy to quantify. One principal indicated that the FFIEC provides a helpful forum for discussion of common issues, from which the member agencies benefit regardless of whether written guidance is issued or not. An agency supervision official noted that the Supervision Task Force will discuss matters without publishing guidance, but because the issue has been raised and discussed, the task force members are more aware of the issue and each agency's position. The official noted that this forum for discussion is a valuable benefit that is not captured in FFIEC annual reports.

### ***FFIEC challenges***

Notwithstanding these accomplishments, the FFIEC has not always issued interagency guidance timely. Several officials were critical of the amount of time it takes the FFIEC to deliberate and



issue guidance on some interagency projects. A number of officials mentioned the FFIEC's project on recourse, direct credit substitutes, and residual interests in asset securitizations (Recourse Project) in particular. The Council initially assigned the Recourse Project to the Supervision Task Force in 1993. The banking agencies began discussing the residual interest issue in mid- to late-1999 and later combined this initiative with the Recourse Project. The task force completed the Recourse Project in late 2001 and the banking agencies issued a final rule in the Federal Register on November 29, 2001.<sup>8</sup>

The Recourse Project was a point of discussion in an October 2001 hearing before the Senate Banking, Housing, and Urban Affairs Committee on the failure of Superior Bank (Superior). During that hearing, the Committee Chairman noted that several recent banks that failed—including the First National Bank of Keystone in 1999 and Superior in 2001—had a common characteristic of holding high concentrations of subprime residual assets. The Chairman also noted that the banking agencies had yet to issue a final rule on the Recourse Project and questioned why the project was taking so long to complete.

Several officials commented on the Recourse Project and offered explanations for project time frames. One principal noted the subject was very complex and that the industry was changing too quickly for the FFIEC to stay abreast. The principal indicated that the agencies had issued several proposed rules for comment, but that each time, the industry had changed so much that the proposed rules were outdated. One supervision official characterized the delay as a function of the financial markets evolving and changing faster than the regulators could react. The official concluded that the banking agencies would have experienced the same problem regardless of the FFIEC's involvement simply because the Recourse Project was a tough issue.

Another principal said that the FFIEC eventually completed the Recourse Project when the principals instructed the task force to concentrate on developing broad economic directives, which would not be as susceptible to changes within the industry, as opposed to developing a list of detailed directives.

### ***Responsiveness to major risks facing the banking industry***

As discussed earlier in this report, interagency guidance may be issued under the auspices of the FFIEC or outside of the FFIEC as joint guidance. Accordingly, to fairly assess interagency coordination, one must review FFIEC and non-FFIEC interagency guidance. In order to determine FFIEC and banking agency responsiveness, we asked representatives from each

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<sup>8</sup> Treasury, FDIC, and FRB issued *Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance; Capital Treatment of Recourse, Direct Credit Substitutes, and Residual Interests in Asset Securitizations; Final Rules* on November 29, 2001 in the Federal Register. Asset securitization is the process by which loans or other credit exposures are pooled and reconstituted into securities that may then be sold. Banks involved in the securitization or sale of assets often provide credit enhancements such as recourse, direct credit substitutes, and residual interests in order to protect investors from incurring credit losses on loans and other financial assets that have been sold or securitized. Recourse arises when a bank retains credit risk on assets it sells if the credit risk exceeds a pro rata share of the bank's claim on the assets. In a direct credit substitute, a bank assumes credit risk on a third-party asset and the risk exceeds the pro rata share of the bank's interest in the asset. A residual interest is an on-balance sheet asset created in an asset sale that exposes a bank to credit risk in excess of its pro rata claim on the asset.

banking agency to identify three to five major risks and emerging issues, between 1997 and 2001, that their agencies considered to be critical banking industry concerns, and to describe what guidance had been issued in response. Table 3 presents the results of this information.

**Table 3: Responsiveness of the FFIEC and the Banking Agencies to Major Risks and Emerging Issues Facing the Banking Industry (1997 through 2001)**

MAJOR RISK OR EMERGING ISSUE	WAS GUIDANCE ISSUED BY:		
	FFIEC?	JOINT INTERAGENCY (NON-FFIEC)?	INDIVIDUAL BANKING AGENCY?
Y2K Preparation	Yes	Yes	Yes
Credit Risk	Yes	Yes	Yes
Electronic Banking	Yes	Yes	Yes
Accounting	Yes	Yes	Yes
Capital Adequacy	Yes	Yes	Yes
Risk Management	Yes	Yes	Yes

Source: OIG analysis of information provided by individual agencies.

Based on the information provided by each of the banking agencies, we concluded that the FFIEC and its member agencies had issued guidance addressing the major risks and issues that the banking agencies identified as critical concerns to the banking industry between 1997 and 2001.

### **FFIEC Efforts to Achieve Uniformity**

The FFIEC Act tasked the Council with establishing "... uniform principles and standards and report forms for the examination of financial institutions which shall be applied by the Federal financial institutions regulatory agencies." An original concern of the Congress was the so-called "competition in laxity" or the tendency for competition among the banking agencies for the favor of regulated firms to result in lax regulation. In short, Congress was concerned that one or more of the banking agencies would practice more lenient bank supervision in order to attract financial institutions to its bank or thrift charter.

The FFIEC attempted to develop joint procedures and report forms several times over the history of the Council, with limited success. According to the FFIEC Historical Study, after a 2-year effort, the Supervision Task Force reported in April 1981 that although interagency agreement might be reached on examination objectives and policies, it could not be reached on examination methods. The FFIEC Historical Study provided the following examples of examination objectives, policies, and methods:

- Objectives relate to evaluating an institution's management, policies and procedures, financial condition, and prospects;
- Policies encompass the frequency and scope of coverage of examinations and the way problem institutions are to be supervised; and

- Methods include the detailed procedures that examiners follow in on-site examinations, working paper format and content, and the examination report form.

The FFIEC Historical Study noted that differences in examination methods arise from the different characteristics of the banking agencies; applicable laws or regulations; relationships with state authorities; and the nature, size, and type of institution being examined (e.g. bank, thrift, or credit union).

We interviewed officials about the need for and feasibility of uniform examination procedures and report forms. Most of the officials noted that the UFIRS and the Call Report are critical areas where uniformity has been achieved.<sup>9</sup> Moreover, several officials indicated that a uniform examination report was neither feasible nor needed and observed that the FFIEC and the banking agencies had developed some joint procedures especially for areas common to each of the banking agencies. Anecdotal comments about the need for a uniform report form included the following:

- One principal noted that the idea of a uniform examination report appeals to one's sense of neatness but questioned the benefits of having a uniform report of examination. The principal stated that uniformity in the UFIRS ratings is more important than a uniform report form and uniformity in the data gathered from Call Reports is essential.
- One supervision official concluded that the banking agencies would never be able to develop a "one-size-fits-all" examination report. However, the official noted that the FFIEC and the banking agencies have achieved similarities with respect to the parameters of examinations (i.e., what areas examinations address). The official questioned whether the idea of a uniform examination report was a "solution in search of a problem."
- A supervision official noted that the concept of a joint bank examination report form is less important now than 20 years ago because the banking agencies' practice of conducting ongoing supervision, targeted exams, and off-site monitoring is replacing the need for a uniform examination report. The official also stated that the banking industry has benefited from banking agencies trying different approaches to supervision over the years because the agencies have learned from each other.

In addition, we noted that the FFIEC and the banking agencies have taken other actions to comply with legislative efforts to achieve uniformity and to reduce duplicative and redundant policies. For example, the FDIC Improvement Act requires each federal banking and thrift agency to report annually to the Senate and House banking committees regarding any differences between the accounting or capital standards among the banking agencies. Further, the banking agencies submit a joint report to Congress annually as required by Section 305 of the Riegle Community Development and Regulatory Improvement Act discussing interagency efforts to improve the coordination and supervision of institutions that are subject to multiple regulators. Appendix VI contains a summary of the recent coordination efforts discussed in those reports.

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<sup>9</sup> The UFIRS is an internal rating system used by federal and state banking regulators for assessing the soundness of financial institutions on a uniform basis and for identifying institutions requiring special supervisory attention.

### ***Regulator shopping and competition in laxity***

With respect to regulator shopping, several officials acknowledged that charter changes occur. However, none of the officials we spoke with indicated that bank owners changed charters in an effort to achieve more lenient supervision. Instead, charter changes generally occur for strategic or business reasons. For example, a bank may wish to expand operations beyond state lines and would convert from a state charter to a national bank charter. Several officials also indicated that bank charter changes may occur because of the cost of supervision, as fees under a national charter are about two-and-one-half times greater than fees under a state charter. None of the officials indicated that a uniform examination report would prevent regulator shopping. Several officials noted there is not a cause and effect relationship between the concept of a uniform examination report and regulator shopping and that the two are not related.

Finally, none of the officials we interviewed indicated that “competition in laxity” was occurring or was a problem. One principal responded that “competition in laxity” is a hypothetical problem and not the reality. Several officials noted that the banking regulators communicate with one another about problem institutions and the receiving agency would be very wary of welcoming a bank that is shopping for regulatory leniency.

### **FFIEC’S ROLE UNDER GLBA**

GLBA, signed into law in November 1999, repealed those portions of the Glass-Steagall Act that prohibited banks, securities firms, and insurance companies from affiliating. Among other things, GLBA created a new FHC structure authorized to engage in a statutorily provided list of financial activities, including insurance and securities underwriting, merchant banking, and insurance company portfolio investment activities. GLBA incorporated the concept of functional regulation, that is, banking activities would continue to be regulated by bank regulators, securities activities by securities regulators, and insurance activities by state insurance regulators. GLBA also established the FRB as the umbrella supervisor of FHCs.<sup>10</sup>

Most officials indicated that GLBA has had little impact on the FFIEC. Further, there was a clear consensus among the officials we interviewed that the FFIEC’s membership should not be expanded to include securities or insurance regulators. Several officials were skeptical of the benefits derived from expanding Council membership and questioned how insurance and securities regulators would be fairly represented on the Council since there are separate insurance commissioners and securities administrators for each state. Moreover, officials we interviewed offered the following additional reasons against expanding the Council.

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<sup>10</sup> According to FRB Supervisory Letter SR 00-13, dated August 15, 2000, FRB is responsible for the consolidated supervision of FHCs. FRB will assess FHCs on a consolidated or group-wide basis with the objective of ensuring that the FHC does not threaten the viability of its depository institution subsidiaries. In a February 2002 speech, an FRB Governor noted that as umbrella supervisor, FRB will rely on the functional supervisor as much as possible and will examine functionally regulated non-bank affiliates only if it believes that their activities are creating risk for the bank affiliate.

- ***There are inherent differences in the mission and responsibilities of the FFIEC and the demands of the GLBA.*** One principal noted that the FFIEC deals with banks, while the FRB has the responsibility for banking organizations under GLBA. Another principal indicated expanding the FFIEC would be an “awful idea” and it would be “disastrous” to bring securities and insurance regulators into the FFIEC. The principal noted that the FFIEC was never intended to implement GLBA and surmised the result would be an awkward, ponderous coordinating entity.

Two officials expressed a concern that expanding the Council’s responsibilities to include GLBA coordination would suggest that FHC supervision is no different from depository institution supervision and might send the signal that protections afforded to banks (e.g., deposit insurance) would also be afforded to FHC non-bank subsidiaries.

- ***Most FFIEC projects do not involve securities or insurance issues.*** For example, one agency official noted the consumer compliance issues that the Task Force on Consumer Compliance addresses have no relevance to the SEC. A supervision official questioned whether there were any issues that would require involvement from all five of the FFIEC member agencies and securities and insurance regulators. Another supervision official noted that broadening the FFIEC’s mission to include GLBA coordination would serve to dilute the banking-related work that the Council is already doing.

## **Interagency Coordination Efforts**

Most officials we interviewed indicated that effective coordination is currently taking place between the banking, insurance, and securities regulators on an as-needed basis. As such, most officials did not favor modeling a new entity after the FFIEC to create a more formalized coordinating structure for implementing GLBA. Instead, officials we spoke with discussed the following on-going efforts for coordinating under GLBA:

- ***Periodic cross-sector meetings hosted by FRB in its umbrella supervisor capacity.*** GLBA established the FRB as the umbrella supervisor of FHCs. FRB has developed a framework for implementing FHC supervision and intends to identify and evaluate, on a consolidated or group-wide basis, the significant risks that exist in a diversified holding company in order to assess how those risks might affect the safety and soundness of depository institution subsidiaries. In that regard, the FRB has hosted cross-sector meetings about three times a year in Washington with representatives from the federal banking agencies, the SEC, state securities regulators, the National Association of Insurance Commissioners (NAIC), and the Commodity Futures Trading Commission (CFTC). Officials characterized these meetings as a good forum for agency representatives to meet, establish contacts, and discuss issues of common concern.

In a February 2001 speech, one principal characterized the cross-sector meetings as an opportunity for multiple supervisors to discuss issues relevant to various financial industries and noted that the meetings were useful for building cooperation and improving each agency’s understanding of the different supervisory authorities and objectives. The FRB has also held cross-sector meetings at the Federal Reserve Bank level with regional and state

banking, securities, and insurance regulators. Further, the NAIC hosts quarterly meetings with the functional regulators that are attended by staff at the operational or working-group level from the banking agencies, insurance regulators, and the SEC.

- ***Bilateral information sharing agreements between the banking agencies and state insurance commissioners.*** The NAIC has taken an active role in approving a model information-sharing agreement for use between individual banking agencies and state insurance commissioners. These agreements provide for the sharing of relevant regulatory information, including information about examinations, enforcement, and consumer protections. By the end of 2001, 45 states had signed agreements with the OTS, 23 states with the OCC, 31 states with the FDIC, and 8 states with the FRB. Further, a state banking regulator representative noted that approximately 30 percent of the state banking commissioners had signed information-sharing agreements with state insurance commissioners. The representative noted that a much larger number of state bank supervisors had informal arrangements with state insurance supervisors to share information. One principal indicated that the NAIC has been effective at coordinating the efforts of the state insurance commissioners.
- ***Coordination with SEC and insurance regulators on a case-by-case basis.*** Several officials noted that interagency coordination is sufficiently occurring on a case-by-case basis. Most officials were in favor of keeping coordination informal instead of creating another formal coordinating entity.

While officials we spoke with were generally positive about the banking agencies' relationship with the NAIC and state insurance regulators, they expressed divergent views about the banking agencies' relationship with the SEC. For example, one agency official noted that the FFIEC had coordinated with the SEC for the ALLL project and that the FDIC and SEC routinely coordinate on accounting issues. An agency supervision official noted that the FRB has had a long-standing relationship with the SEC in implementing Section 20 of the Glass-Steagall Act (which prohibited broad affiliations between banking, insurance, and securities industries). The official indicated that the FRB and SEC have worked together on examinations over the past 15 years.

However, a supervision official noted that while his agency had successfully signed information-sharing agreements with state insurance commissioners, coordination with the SEC had not been as successful. A banking industry association representative indicated that there was a need for better dialogue between the banking agencies and the SEC. Further, one principal indicated that the relationship between the FRB and the SEC needed to be improved and another principal noted that the FRB is working with the SEC on a case-by-case basis, but to date there is no overall MOU for sharing information about broker-dealers in FHCs. The principal indicated that sharing information is the biggest challenge facing the banking agencies and the SEC because of privacy issues and the different missions of the agencies.

## CONCLUSIONS

Congress created the FFIEC in 1979 to prescribe uniform principles, standards, and report forms for the federal banking agencies. The FFIEC is accomplishing its mission, and most officials we interviewed were not in favor of making legislative changes to the FFIEC Act. Notwithstanding, most officials acknowledged that the Council could operate more effectively and could complete interagency projects more timely. In that regard, the FFIEC Chairman has presented a number of suggestions for making the FFIEC more effective. We suggest that the Council memorialize these ideas in a more permanent document, such as the FFIEC's *Rules of Operations*, to better ensure that future Council members continue to practice those measures. We also encourage the FFIEC to look for opportunities to improve communication with the trade associations, where appropriate.

We concluded that the FFIEC and the banking agencies had issued guidance responsive to major risks and issues that the banking agencies considered to be critical banking industry concerns. Further, most officials indicated that the FFIEC and the banking agencies had achieved uniformity in critical areas.

With respect to the FFIEC's role under GLBA, most officials indicated that GLBA had not significantly impacted the FFIEC and were not in favor of expanding the Council to include regulatory representatives from the insurance and securities industries. Nor were most officials in favor of developing a separate coordinating group modeled after the FFIEC to coordinate GLBA activities. Finally, most officials indicated that interagency coordination required under GLBA was occurring as needed on a case-by-case basis.

## AGENCY COMMENTS AND OUR EVALUATION

We provided the FFIEC member agencies a draft of this report on May 7, 2002. The OTS, FRB, OCC, and FDIC provided written responses. The FRB, OCC, and FDIC responses concurred with the report's conclusions that the FFIEC is achieving its mission of prescribing uniform principles and standards and that the FFIEC coordination role should not be expanded because of GLBA. We have summarized significant points made by each agency below and corrected factual inaccuracies in the text of the report. We also include copies of the agency responses in Appendix II.

The OTS's response did not specifically comment on the overall conclusions but clarified certain points regarding financial reporting for thrift institutions and the time period that work was performed by the FFIEC on the "Recourse Project." We clarified these points in the body of the report.

The FRB's response noted that the FFIEC was not designed as a representative agent for the member agencies and has limited staff, resources, and expertise to carry out an expansion of its duties. The response also stated that communications with trade associations should come directly from the agencies themselves. Further, the FRB's response stressed that the FFIEC primarily functions as a coordination and communication facilitating entity and that it is the

responsibility of the principals of each member agency to act upon the FFIEC recommendations and to implement policies. Finally, the FRB's response identified an inaccurate reference in the report and pointed out that the cross sector meetings were also attended by state security regulators and the CFTC. These final two points were clarified in the text of the report.

The OCC's response, in addition to providing a number of technical clarifications:

- Stated that the informal mechanisms that agencies have in place for communicating with industry trade groups are appropriate and adequate and that questions about a proposed policy or interpretation of existing policies would be best addressed by an institution's primary regulator rather than an identified FFIEC point of contact.
- Disagreed with comments provided by agency and banking industry representatives that the FFIEC could be more effective if state regulators were given voting rights on Council matters. The response also questioned how the state voting presence would represent the viewpoints of all of the state regulators and how the operating costs of the FFIEC would be shared among the voting members.
- Clarified that the higher fees that national banks pay, relative to state chartered institutions, are not because the OCC incurs higher costs in carrying out its supervision, but rather reflects the fact that the OCC must pass along all of its costs to its supervised institutions while most of the supervision costs for state chartered institutions are absorbed by the FRB and the FDIC.
- Pointed out that each of the banking agencies are working to develop MOUs with the SEC for sharing information and that each of the banking agencies coordinate with the SEC on accounting issues. The response also noted that the President's Working Group is another vehicle that provides an opportunity for collaboration among financial regulators. This group is sponsored by Treasury and includes representatives from FRB, FDIC, OCC, SEC, and the CFTC.
- Indicated that the discussion of GLBA provisions was overly simplistic and that our discussion of FRB's umbrella supervisor role did not adequately reflect the provisions and restrictions that GLBA places on the FRB relative to depository institutions.
- Noted that the banking agencies had developed and, for many years, used a Uniform Common Core Report of Examination (uniform ROE). However, as the diversity of the banking industry increased, this report became less relevant and less helpful to bank management. In November 2000, the Supervision Task Force agreed with a recommendation from the FDIC to permit more flexibility in how the uniform ROE was used.

Where appropriate, we modified the text of the report to reflect OCC's comments.

The FDIC's response acknowledged that the FFIEC could operate more effectively and efficiently and noted that the FFIEC Steering Committee had commissioned a staff level FFIEC Review Group to evaluate the effectiveness of the FFIEC. The Review Group completed a report, entitled *The FFIEC Operations Review Report*, in May 2002, which will be presented to the FFIEC on June 24, 2002. This report could be a first step in addressing our suggestion that permanent measures be implemented consistent with the current Chairman's initiatives to improve the effectiveness of the FFIEC.



## OBJECTIVES, SCOPE, AND METHODOLOGY

We initiated this review as a result of an audit survey of the FFIEC that the banking agency Inspector General offices conducted during early 1998. That review recommended additional work in several areas, including reviewing the Council's effectiveness in coordinating regulatory issues and fostering its legislative mandates and goals. In March 31, 1999, the Treasury, FDIC, FRB, and NCUA Offices of Inspector General issued a report entitled, *Joint Review of the Federal Financial Institutions Examination Council's Training Program*.

Our initial engagement letter, dated October 4, 2001, referenced the training program report and included an overall objective to assess the remaining aspects of the FFIEC's mission:

(1) prescribing uniform federal examination principles, standards, and report formats for examinations of financial institutions; (2) recommending uniformity in supervisory matters; and (3) developing uniform financial institution reporting systems.

In November 2001, we met with staff representatives from the Subcommittee on Oversight and Investigations, Committee on Financial Services, U.S. House of Representatives. The Subcommittee staff asked us about the Council's efforts to accomplish its mission and whether the FFIEC should have a broadened role in coordinating activities of banking, insurance, and securities regulators, or whether a separate group should be developed and modeled after the FFIEC for coordinating under the GLBA. The Subcommittee staff also asked us to: (1) obtain the views of banking industry associations regarding FFIEC effectiveness and communication efforts and (2) determine whether the FFIEC had issued a joint examination report form and whether such a form would prevent regulator shopping from occurring.

Accordingly, we refocused the objectives of our review to evaluate whether the FFIEC:

- is meeting its mission of prescribing uniform principles and standards for the examination of financial institutions and
- should have an increased coordinating role as a result of the GLBA.

### Evaluation Scope

To accomplish our evaluation, we interviewed Council principals, banking agency supervision officials, and representatives from banking trade associations. We also reviewed documentation from the FFIEC and member banking agencies. However, because the FFIEC does not currently develop goals and objectives or maintain project time frame information, we were unable to readily measure the FFIEC's performance or perform a detailed analysis to assess how timely the Council and task forces completed individual interagency projects.

Our evaluation addressed the views and interagency efforts of the FFIEC and its member agencies. We generally reviewed guidance issued by the FFIEC and its member agencies during the period 1997 through 2001. Because the FFIEC's training program had been the subject of a

prior OIG review, our evaluation did not address the training function, and we did not interview members of the FFIEC's Examiner Education Task Force.

We conducted our evaluation between October 2001 and March 2002, in accordance with the President's Council on Integrity and Efficiency's *Quality Standards for Inspections*.

## **Methodology**

To meet our objectives we performed the following work:

- Interviewed the following officials:
  - Five current or former FFIEC principals and obtained the views of the FFIEC Chairman through his special advisor;
  - Selected task force members and agency supervision officials;
  - FFIEC's Executive Secretary, Deputy Executive Secretary, and UBPR Coordinator;
  - Representatives from the American Bankers Association, America's Community Bankers; and Independent Community Bankers of America; and
  - Representatives from the Conference of State Bank Supervisors and the National Association of Insurance Commissioners.
- We also attempted to contact representatives from the Securities and Exchange Commission, but were unable to obtain their views about the FFIEC and coordination under GLBA.
- Observed an FFIEC Council meeting and monthly task force meetings held by the Supervision Task Force and the Task Force on Consumer Compliance.
- Reviewed Council minutes, task force project listings, and other documentation maintained at FFIEC Headquarters.
- Reviewed FFIEC Annual Reports and information maintained on the FFIEC's Web site to determine FFIEC accomplishments.
- Obtained information from the OCC, OTS, FDIC, and FRB regarding the major risks and emerging issues facing the banking industry and guidance issued in response.

## AGENCY COMMENTS



**Office of Thrift Supervision**  
 Department of the Treasury

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*Richard M. Riccobono*  
 Deputy Director

May 24, 2002

**MEMORANDUM FOR:** Donald R. Kassel, National Director  
 Banking and Fiscal Service  
 Office of the Inspector General

**FROM:** Richard M. Riccobono *Richard M. Riccobono*

**SUBJECT:** Draft Audit Report on the Evaluation of the  
 Federal Financial Institutions Examination  
 Council (FFIEC)

We received your draft audit report entitled *Joint Evaluation of the Federal Financial Institutions Examination Council*, on May 8, 2002. We appreciate the opportunity to review the report and provide the comments that follow.

Reference is made to the term "standard quarterly financial reports submitted by commercial banks and thrifts to the FDIC" in the first paragraph of page 7. The wording of the sentence is somewhat misleading as it relates to thrift institutions regulated by OTS. The FDIC's Call Report was developed under the auspices of the FFIEC through its Reports Task Force. Thrift institutions regulated by OTS file the Thrift Financial Report (TFR), which is materially different from the Call Report. We note that the TFR was not developed under the auspices of the FFIEC.

The dates associated with work performed on the FFIEC's project on recourse, direct credit substitutes, and residual interests in asset securitizations (the "Recourse Project") mentioned on pages 16 and 17 of the report is also somewhat misleading. The report indicates that the Recourse Project was assigned to the FFIEC Supervision Task Force in 1993 and completed in late 2001.

Interagency discussions on the residuals issue began in mid- to late-1999 after the failure of First National Bank of Keystonc. The first draft of a proposed rule was circulated among the banking regulators in December 1999, and the Notice of Proposed Rule Making (NPRM) was published in September 2000. It was combined with the Recourse Project only after the comment period on the Residuals NPRM closed. From inception to the final rule, the residuals issue took approximately two years to resolve.

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We thank you for the opportunity to review and respond to the draft report. My staff has provided technical comments directly to the audit team members.

cc: Director Gilleran  
Bernie Mason  
John Price



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

ROGER W. FERGUSON, JR.  
VICE CHAIRMAN

May 29, 2002

To: Barry Snyder

From: Vice Chairman Roger W. Ferguson, Jr. *RWF, Jr.*

Subject: Draft Report on the Joint Evaluation of the Federal Financial Institutions  
Examinations Council

Thank you for the opportunity to review and provide comments on the *Joint Evaluation of the Federal Financial Institutions Examination Council*. I understand this review was conducted in tandem with the Inspector General Offices from the Department of the Treasury and the Federal Deposit Insurance Corporation. I also understand your objectives were to evaluate whether (1) the FFIEC is meeting its mission and (2) the FFIEC should have an increased coordinating role for the agencies in light of the Gramm-Leach-Bliley Act.

Generally the report does not include recommendations, although I agree with the findings of the report that the FFIEC is fulfilling its legislative mission and that the FFIEC's coordination role should not be expanded to include additional regulators. I also understand a formal written response is not necessary, but I do have several broad comments on the draft report that I would like to mention.

First, the report notes that the FFIEC should look for opportunities to improve communications with trade associations. While we strongly encourage communications on multiple levels, it is not clear that the FFIEC is the appropriate vehicle for communications as noted in the report. The FFIEC member agencies have different mandates and supervise different types of institutions. Further, the FFIEC was not designed as a representative agent for the member agencies and has limited staff, resources, and expertise to carry out an expansion of its duties. Therefore, it is our position that communications with trade associations should come directly from the agencies themselves.

Second, the report is structured in many places as recitations of views and opinions of individuals who were interviewed for the project. In some places the report indicates that these remarks are statements of fact when, in fact, the statements are not accurate. For example, on page 8 there is a reference to the fact that the FFIEC is subject

to the Sunshine Act. The FFIEC is not, in fact, subject to the Sunshine Act. While the sentence is written as a characterization made by one principal, it could be interpreted as a statement of fact that would be incorrect.

Third, in some areas the report seems to emphasize the FFIEC's role as a policy-making entity. The FFIEC does make policy-related recommendations to the agencies for final decisions. However, the FFIEC primarily functions as a coordination and communication facilitating entity. It is the responsibility of the principals of each member agency to act upon the FFIEC recommendations and to implement policies.

Fourth, in the section that discusses interagency coordination efforts, the reference to FRB-hosted cross sector meetings is appreciated. These meetings have been informative and useful in improving supervisory relationships across the sectors. I would like to note, however, that in addition to the regulatory authorities noted in the paragraph, state securities regulators and the CFTC also participate in these meetings.

I trust you will find these comments helpful, and if you would like to discuss any of them in greater detail do not hesitate to give me a call. Alternatively, you may contact Barbara Bouchard in the Division of Banking Supervision and Regulation at extension 3072.



## MEMORANDUM

Comptroller of the Currency  
Administrator of National Banks

Washington, DC 20219

To: Donald R. Kassel, National Director, Banking and Fiscal Service

From: John D. Hawke, Jr., Comptroller of the Currency

Date: May 30, 2002

Subject: Draft Report - Joint Evaluation of the Federal Financial Institutions Examination Council

The OCC appreciates the opportunity to review the draft evaluation report prepared jointly by the Offices of Inspector General (OIGs) of the Department of the Treasury (Treasury), the Federal Deposit Insurance Corporation (FDIC) and the Board of Governors of the Federal Reserve System (FRB). The draft report is titled *Joint Evaluation of the Federal Financial Institutions Examination Council* (FFIEC or Council). We concur with the report's general findings that the FFIEC is meeting its legislative mission and that further expansion of the FFIEC's membership and mission is not needed to address the functional supervision issues raised by the Gramm-Leach-Bliley Act (GLBA). The OCC also supports the OIGs' general suggestions that the FFIEC should continue to look for opportunities to improve the efficiency of FFIEC deliberations and projects and to improve communications with the industry. However, we would also reinforce the comments in the report that stress the need for the FFIEC to maintain flexibility in responding to emerging risks and to minimize the amount of bureaucracy imposed by the FFIEC structure and operations.

Specific comments on aspects of the report are provided below.

### **Improving Communications with Industry Trade Groups**

The OIGs recommend several possible actions to improve communications with industry trade groups, including the publication of an annual agenda and providing task force points of contact on the FFIEC's web-site so that industry groups can communicate directly with project staff. The OCC concurs with the benefits of maintaining dialog with industry trade groups and believes that the informal mechanisms the agencies have in place are appropriate and adequate. These mechanisms include joint meetings between agency staffs and trade group representatives and consulting with trade groups on draft policy statements, as needed and appropriate. Industry trade groups also have an opportunity to share their views via the agencies' notice and comment process.

We believe that questions about a proposed policy issuance or interpretations and applications of existing policies and regulations are best addressed by an institution's primary regulator rather than an identified "FFIEC" point of contact. We are concerned that providing points of contact

via an FFIEC web-site may cause some institutions to "opinion-shop" on complex issues where the interpretation and application of guidance may be very fact specific.

#### **Voting Rights for States**

We strongly disagree with the suggestion that the FFIEC could be more effective if state regulators were given voting rights on Council matters. Providing voting rights to state regulators would, in our opinion, make the FFIEC deliberations much more unwieldy and inefficient. The practical outcome of such a provision would be a movement towards discussing and approving policies on an interagency basis outside of the FFIEC. In addition, it is not clear that a single voting member or group of members would necessarily represent the viewpoints of all state regulators for all the member constituencies (i.e., thrifts, banks, and credit unions).

It is important to note that the states currently do not share the costs associated with the FFIEC nor do they provide staff resources for the Council's work. Indeed, the states benefit from having national banks and thrifts directly subsidize the salary of the FFIEC's Assistant Executive Secretary and Coordinator for State Liaison Committee Activities via the semiannual assessments that the OCC and Office of Thrift Supervision (OTS) pay for Council staff expenses. The states also benefit from the policy development work that is contributed on a gratis basis by the banking agencies.

#### **Fee Disparity and Reasons for Charter Conversions**

The report correctly notes that differences in the cost of supervision borne by banks is a more important factor in bank charter conversions than are differences in supervisory practices and reports. However, the characterization of these cost differences, as discussed on page 21, mistakenly suggests that the OCC's costs of supervision are disproportionately higher than those of the FDIC and FRB. The higher fees that national banks must pay, relative to state chartered institutions, is not because the OCC incurs higher costs in carrying out its supervision but rather reflects the fact that the OCC must pass along all of its costs to its supervised institutions. The costs for state chartered institutions, in contrast, are absorbed by the FRB and the FDIC, who perform for state banks exactly the same supervisory functions that the OCC performs for national banks. Thus, state bank supervision costs are subsidized by the deposit insurance premiums paid by all insured institutions (in the case of the FDIC) and by the interest earned by the FRB on its investments that are not remitted to the Treasury.

Although beyond the scope of this particular report, the OCC believes that the fact that nationally chartered banks and thrift institutions subsidize the costs of state supervision compels a re-look at the methods used to allocate various costs of the FFIEC among member agencies. Current methods of allocation cause these costs to fall disproportionately on national banks, since national banks bear directly all of OCC's costs, while state banks share none of the burden of FFIEC's costs, since these costs are absorbed by the FRB and the FDIC. This is an issue that we will continue to raise with other Council members.

#### **Summary of GLBA Provisions and FRB's Role as Umbrella Supervisor**

We believe that the report's summary of the substantive provisions of GLBA is overly simplistic and needs to be redrafted. The report also should place increased focus on the various



information sharing mechanisms (both formal and informal) that all of the banking agencies have with various functional regulators such as state insurance commissioners and the Securities and Exchange Commission (SEC). For example, all of the banking agencies -- not just the FRB -- are working on memoranda of understanding (MOUs) for information sharing with the SEC. These MOUs would supplement and enhance information sharing that already takes place on a more informal basis. Similarly, all of the banking agencies -- not just the FDIC -- routinely coordinate with the SEC on accounting issues. Indeed, the banking agencies' and SEC's chief accountants hold regular meetings to discuss issues of common interest.

We are also concerned that the discussion of the FRB as "umbrella supervisor" does not adequately reflect the provisions and restrictions that GLBA places on the FRB relative to depository institutions. As we noted in our meetings with the OIGs, the use of the term "umbrella supervisor" in GLBA is solely in the context of insurance regulation; GLBA left the relative roles of the banking agencies largely unchanged. Indeed, if anything, Congress reinforced the role of the primary regulator by explicitly requiring the FRB "to the fullest extent possible, limit the focus and scope of any examination of a banking holding company to: i) the bank holding company; and ii) any subsidiary of the bank holding company that could have a materially adverse effect on the safety and soundness of any depository institution subsidiary..." [emphasis added]. We believe this statutory mandate is considerably more restrictive than what is implied in the report's discussion and footnote on page 22.

We would also note that the President's Working Group is another vehicle that provides an opportunity for collaboration among financial regulators. This group, sponsored by Treasury, includes representatives from the FRB, FDIC, OCC, Commodity Futures Trading Commission (CFTC), and SEC.

#### **Uniform Report of Examination**

We concur with the report's conclusion that the presence or absence of a uniform report of examination (ROE) is not a factor that leads an institution to change its bank charter and that this issue is "a solution in search of a problem" (page 20). The report mistakenly implies, however, that the agencies never developed a uniform examination report. The agencies developed and for many years used a Uniform Common Core Report of Examination (uniform ROE). As the diversity of the banking industry increased, both in size and breadth of operations, this uniform report became less relevant for many of the institutions each agency oversees. More recently, the agencies determined that for small, non-complex banks, the uniform ROE, rather than the underlying risk of the financial institution, was often driving examination strategies and work. The result was an examination scope and report that was not helpful to bank management and that often imposed unnecessary burdens, in terms of examiner time, on the banks. In response to these problems, the FFIEC's Supervision Task Force in November 2000, agreed with a recommendation from the FDIC to permit more flexibility in how the uniform ROE is used.

#### **Technical Corrections**

We also noted a number of items in the report that we believe are technically incorrect. These are listed below.

- *Page 6 - Role of Task Forces* - We suggest modifying the first sentence to reflect that the FFIEC task forces generally prepare policy statements. They can approve such statements under delegated authority if there is unanimous approval by task force members.
- *Page 7 - MOUs with SEC* - As noted in our comments above, the OCC (and we believe, other banking agencies) are working to develop MOUs on information sharing with the SEC and have arrangements to share critical information on a case-by-case basis. The report, as drafted, mistakenly implies that only the FRB has such efforts and arrangements underway.
- *Page 8 - Applicability of Sunshine Act* - Contrary to the statement on page 8, it is our understanding that the FFIEC has a legal opinion that indicates that it is not subject to the Sunshine Act. In this regard, we would note that the Council and task force meetings are not open to the public. The FFIEC should be able to provide you with this analysis.
- *Page 11 - State Participation on Task Forces* - The report notes that representatives from the State Liaison Committee (SLC) participate in Supervision Task Force meetings. In a response to the SLC's request, SLC members were also invited to participate (as observers) in the FFIEC's Information Task Force. We suggest confirming this with the FFIEC's Executive Secretary.
- *Page 24 - Coordination with SEC on Accounting Issues* - As noted above, all of the banking agencies coordinate with the SEC on accounting issues, not just the FDIC.




Federal Deposit Insurance Corporation  
550 17th St. NW Washington DC, 20429

Deputy to the Chairman and COO

June 7, 2002

MEMORANDUM TO: Gaston L. Gianni  
Inspector General

FROM: John F. Bovenzi   
Deputy to the Chairman and  
Chief Operating Officer

SUBJECT: Draft Report on the Joint Evaluation of the Federal Financial  
Institutions Examination Council (FFIEC)

Thank you for the opportunity to review and comment on the draft report entitled *Joint Evaluation of the Federal Financial Institutions Examination Council (FFIEC)*.

Although the report does not include formal recommendations, we concur with the general conclusions that the FFIEC is achieving its mission of prescribing uniform principles and standards, and that the FFIEC's coordination role should not be expanded because of the Gramm-Leach-Bliley Act (GLBA).

We also recommend a change on page 6, second paragraph, last sentence, to note that data processing costs represented the most significant portion of the FFIEC's annual budget.

cc: Michael Zamorski  
Vijay G. Deshpande

**LIST OF ACRONYMS**

ALLL	Allowance for Loan and Lease Losses
CFTC	Commodity Futures Trading Commission
CRA	Community Reinvestment Act
CSBS	Conference of State Bank Supervisors
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
FHC	Financial Holding Company
FRB	Board of Governors of the Federal Reserve System
GLBA	Gramm-Leach Bliley Act
HMDA	Home Mortgage Disclosure Act
MOU	Memorandum of Understanding
NAIC	National Association of Insurance Commissioners
NCUA	National Credit Union Administration
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision
SEC	Securities and Exchange Commission
SLC	State Liaison Committee
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System
Y2K	Year 2000 Date Change

## ENACTING LEGISLATION

92 STAT. 3694

PUBLIC LAW 95-630—NOV. 10, 1978

subsection in any other report required to be filed by all insured banks which would be available in its entirety to the public upon request.

"(4) Copies of any report required to be filed under this subsection shall be made available, by the appropriate Federal banking agency or by the bank, upon request, to the public."

Federal Financial  
Institutions  
Examination  
Council Act of  
1978.  
Short title.  
12 USC 3301  
note.

#### TITLE X—FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

SEC. 1001. This title may be cited as the "Federal Financial Institutions Examination Council Act of 1978".

##### PURPOSE

12 USC 3301.

SEC. 1002. It is the purpose of this title to establish a Financial Institutions Examination Council which shall prescribe uniform principles and standards for the Federal examination of financial institutions by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Federal Home Loan Bank Board, and the National Credit Union Administration and make recommendations to promote uniformity in the supervision of these financial institutions. The Council's actions shall be designed to promote consistency in such examination and to insure progressive and vigilant supervision.

##### DEFINITIONS

12 USC 3302.

SEC. 1003. As used in this title—

(1) the term "Federal financial institutions regulatory agencies" means the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the National Credit Union Administration;

(2) the term "Council" means the Financial Institutions Examination Council; and

(3) the term "financial institution" means a commercial bank, a savings bank, a trust company, a savings and loan association, a building and loan association, a homestead association, a cooperative bank, or a credit union;

##### ESTABLISHMENT OF THE COUNCIL

Financial  
Institutions  
Examination  
Council.  
12 USC 3303.

SEC. 1004. (a) There is established the Financial Institutions Examination Council which shall consist of—

(1) the Comptroller of the Currency,

(2) the Chairman of the Board of Directors of the Federal Deposit Insurance Corporation,

(3) a Governor of the Board of Governors of the Federal Reserve System designated by the Chairman of the Board,

(4) the Chairman of the Federal Home Loan Bank Board, and

(5) the Chairman of the National Credit Union Administration Board.

Members.

(b) The members of the Council shall select the first chairman of the Council. Thereafter the chairmanship shall rotate among the members of the Council.

Term.

(c) The term of the Chairman of the Council shall be two years.

(d) The members of the Council may, from time to time, designate other officers or employees of their respective agencies to carry out their duties on the Council.

(e) Each member of the Council shall serve without additional compensation but shall be entitled to reasonable expenses incurred in carrying out his official duties as such a member.

#### EXPENSES OF THE COUNCIL

SEC. 1005. One-fifth of the costs and expenses of the Council, including the salaries of its employees, shall be paid by each of the Federal financial institutions regulatory agencies. Annual assessments for such share shall be levied by the Council based upon its projected budget for the year, and additional assessments may be made during the year if necessary. 12 USC 3304.

#### FUNCTIONS OF THE COUNCIL

SEC. 1006. (a) The Council shall establish uniform principles and standards and report forms for the examination of financial institutions which shall be applied by the Federal financial institutions regulatory agencies. Principles and standards. 12 USC 3305.

(b) (1) The Council shall make recommendations for uniformity in other supervisory matters, such as, but not limited to, classifying loans subject to country risk, identifying financial institutions in need of special supervisory attention, and evaluating the soundness of large loans that are shared by two or more financial institutions. In addition, the Council shall make recommendations regarding the adequacy of supervisory tools for determining the impact of holding company operations on the financial institutions within the holding company and shall consider the ability of supervisory agencies to discover possible fraud or questionable and illegal payments and practices which might occur in the operation of financial institutions or their holding companies.

(2) When a recommendation of the Council is found unacceptable by one or more of the applicable Federal financial institutions regulatory agencies, the agency or agencies shall submit to the Council, within a time period specified by the Council, a written statement of the reasons the recommendation is unacceptable.

(c) The Council shall develop uniform reporting systems for federally supervised financial institutions, their holding companies, and nonfinancial institution subsidiaries of such institutions or holding companies. The authority to develop uniform reporting systems shall not restrict or amend the requirements of section 12(i) of the Securities Exchange Act of 1934. Reporting systems.

(d) The Council shall conduct schools for examiners and assistant examiners employed by the Federal financial institutions regulatory agencies. Such schools shall be open to enrollment by employees of State financial institutions supervisory agencies under conditions specified by the Council.

(e) Nothing in this title shall be construed to limit or discourage Federal regulatory agency research and development of new financial institutions supervisory methods and tools, nor to preclude the field testing of any innovation devised by any Federal regulatory agency.

(f) Not later than April 1 of each year, the Council shall prepare an annual report covering its activities during the preceding year. Annual report.

## STATE LIAISON

Establishment.  
12 USC 3306.

Allowance.

Sec. 1007. To encourage the application of uniform examination principles and standards by State and Federal supervisory agencies, the Council shall establish a liaison committee composed of five representatives of State agencies which supervise financial institutions which shall meet at least twice a year with the Council. Members of the liaison committee shall receive a reasonable allowance for necessary expenses incurred in attending meetings.

## ADMINISTRATION

12 USC 3307.

Sec. 1008. (a) The Chairman of the Council is authorized to carry out and to delegate the authority to carry out the internal administration of the Council, including the appointment and supervision of employees and the distribution of business among members, employees, and administrative units.

(b) In addition to any other authority conferred upon it by this title, in carrying out its functions under this title, the Council may utilize, with their consent and to the extent practical, the personnel, services, and facilities of the Federal financial institutions regulatory agencies, Federal Reserve banks, and Federal Home Loan Banks, with or without reimbursement therefor.

(c) In addition, the Council may—

(1) subject to the provisions of title 5, United States Code, relating to the competitive service, classification, and General Schedule pay rates, appoint and fix the compensation of such officers and employees as are necessary to carry out the provisions of this title, and to prescribe the authority and duties of such officers and employees; and

(2) obtain the services of such experts and consultants as are necessary to carry out the provisions of this title.

Experts and  
consultants,  
services.

## ACCESS TO INFORMATION BY THE COUNCIL

12 USC 3308.

Sec. 1009. For the purpose of carrying out this title, the Council shall have access to all books, accounts, records, reports, files, memorandums, papers, things, and property belonging to or in use by Federal financial institutions regulatory agencies, including reports of examination of financial institutions or their holding companies from whatever source, together with workpapers and correspondence files related to such reports, whether or not a part of the report, and all without any deletions.

## AUDITS BY THE COMPTROLLER GENERAL

31 USC 67.

Sec. 1010. Section 117 of the Accounting and Auditing Act of 1950, as amended by the Federal Banking Agency Audit Act (Public Law 95-380), is further amended by:

(1) redesignating clauses (A), (B), and (C) of subsection (e)(1) as (B), (C), and (D), respectively, and inserting in subsection (e)(1) the clause "(A) of the Financial Institutions Examination Council;" immediately following "audits"; and

(2) striking out in subsection (e)(2) "and (C)" and inserting in lieu thereof "(C), and (D)".

## FFIEC CHAIRMAN'S MEMORANDUM



Federal Deposit Insurance Corporation  
550 17th St. NW Washington DC, 20429

Office of the Chairman

December 12, 2001

TO: FFIEC PRINCIPALS

FROM: DONALD E. POWELL  
CHAIRMAN

SUBJECT: FFIEC EFFECTIVENESS IN 2002

At breakfast last week, I promised all of you I would prepare a brief memorandum outlining my thoughts on how to make the FFIEC more effective in 2002.

The FFIEC was established by Congress in 1978. The Council's mandate was to "prescribe uniform principles and standards for the Federal examination of financial institutions . . . and make recommendations to promote uniformity in the supervision of these financial institutions." As the Council's chairman, I have an obligation to ensure the organization accomplishes this task while making a meaningful contribution to the ongoing dialogue between the regulators. I also have an obligation to ensure the organization reaches timely conclusions on matters of importance to us and to the industry. With your help, we can make this happen.

We have an outstanding opportunity next year to improve our working relationships, and this is certainly one of my top priorities. The FFIEC can and should be part of this effort. In my view, its ability to do so depends on us setting common goals and demanding accountability from the FFIEC and agency staffs. Below are a few of my thoughts on how we can accomplish this. I welcome your input and look forward to working with you to ensure an effective and improved FFIEC process in 2002.

1. **CLARIFY FFIEC MISSION.** All of us at the Principal level need to agree at the outset what role the FFIEC is going to play in our joint activities. I'll suggest something simple: "The FFIEC will fulfill its statutory mandate and facilitate communication and coordination among the bank regulatory agencies on matters of mutual concern and requiring joint action. The FFIEC should be timely in its deliberations and efficient in its operations."
2. **ACTIVE INVOLVEMENT OF THE PRINCIPALS.** I would like to see each of us actively involved in monitoring the activities of the FFIEC and working closely with our staffs to ensure the organization's goals and objectives are met.
3. **SET GOALS AND OBJECTIVES.** Every year, the FFIEC should set its goals and objectives. These should be accompanied by timetables that make clear when projects will get done and how much they will cost. Staff should provide a regular accounting to the



principals on how we are doing. The principals should agree on a 'fast track' procedure that allows for expedited consideration of projects that arise due to unexpected events or someone's good idea.

4. **MEETING CONTROL.** Meetings should be in control of the principals, with the professional employees of the FFIEC working in a supportive role. Each meeting should include a brief update from the professional employees of the Council on projects that are not on schedule or on budget. Further, the meeting agendas should be prepared with input from and approval of the principals.
5. **MORE FREQUENT MEETINGS.** Meeting more frequently would enhance the communications function, improve involvement of the principals, and provide opportunities for staff accountability.
6. **DISPUTE RESOLUTION.** The principals should agree on a process for quickly identifying areas of impasse at the staff level and should design a dispute settlement mechanism.
7. **PRIORITIZATION OF WORK.** We should provide staff with guidance as to which projects on the list have priority. And we should provide them the conceptual direction they need to resolve the issues and proceed to resolution.
8. **NOTIFICATION.** Principals should be notified at least two weeks in advance of meetings about new items on the agenda to facilitate meaningful discussion.

Of course, I am open to hearing your views on any of the above. I will call a meeting of the FFIEC for early February. The purpose of this meeting will be to receive a full accounting of the projects before the Council, a brief description of the status, and a listing of outstanding issues. I will instruct my staff to work with the other agencies and the Council staff to develop a 2002 priorities list and timelines for the resolution of each of these agenda items.

Further, this meeting will develop a list of the goals the principals wish the FFIEC to accomplish in 2002. I will be soliciting your input over the next 60 days and I hope you will share your priorities with us. I pledge to you that the FDIC will work constructively and in good faith to resolve issues and address outstanding items.

I wish each of you a happy and joyous holiday season. I look forward to working with each of you on improving the effectiveness of the FFIEC in the new year.

## OTHER EFFORTS TO COORDINATE

The FFIEC and the banking agencies have also taken other actions to comply with legislative efforts to achieve uniformity and to reduce duplicative and redundant policies. For example, the FDIC Improvement Act requires each federal banking and thrift agency to report annually to the Senate and House banking committees regarding any differences between accounting or capital standards among the banking agencies. The OCC submitted the most recent report to the Congress in February 2001. The report noted:

- That since the adoption of the risk-based capital guidelines in 1989, the banking agencies (OCC, OTS, FDIC, and FRB) have applied similar capital standards to the institutions they supervise. In 1995 and 1996, the banking agencies amended their capital standards to include an interest rate risk component and a market risk component, respectively.
- Several remaining differences, including differences in the capital treatment of financial and non-financial subsidiaries, merchant banking activities, and mortgage-backed securities.
- No significant interagency differences in accounting principles and noted that the banking agencies have fully adopted Generally Accepted Accounting Principles as the reporting basis for the Call Report and Thrift Financial Report.

The banking agencies also submit a joint report to Congress annually as required by Section 305 of the Riegle Community Development and Regulatory Improvement Act discussing interagency efforts to improve the coordination and supervision of institutions that are subject to multiple regulators. The banking agencies submitted the most recent report in January 2002. This report addressed coordination efforts by the banking agencies including:

- Joint training efforts, seminars, and symposiums to discuss topics of mutual interest.
- Coordination of state-chartered bank supervision to ensure a risk-focused process and reduce regulatory burden. The FDIC, FRB, and state regulators participate in these efforts.
- Development of a protocol for FDIC participation in or conduct of Special Examinations of insured depository institutions for which the FDIC is insurer but not the primary regulator.
- FRB-hosted cross-sector meetings.
- Participation in global supervisory groups, including the Basel Committee on Banking Supervision and the Joint Forum.
- Coordination of the supervision of U.S. operations of foreign banking organizations through the Foreign Banking Organizations Program.
- Coordination of efforts and guidance related to information technology, asset securitization, subprime lending, the Shared National Credit program, CRA, anti-money laundering and terrorist measures, capital standards, ALLL, and regulatory forms and reporting.